The Modern Lender's Guide to HELOC

The Drivers, the Market and How to Capitalize on this Growing Trend

EllieMae

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Introduction

The home equity line of credit (HELOC) is making a comeback—in a big way.

Skyrocketing housing prices and shrinking inventory levels have prompted more homeowners to rethink their next move. Instead of searching for a new residence, an increasing number of consumers are now choosing to stay where they are and use the equity that has accumulated in their homes to renovate their living space, take a dream vacation, or consolidate other debt.

In the fourth quarter of 2018, more than 14.5 million American properties were equity-rich, meaning they carried secured loans of 50 percent or less of the homes' estimated market value.[1] That fact, in combination with a variety of other economic factors, have created a significant opportunity for mortgage lenders in the HELOC space.

In this eBook, Ellie Mae has partnered with Experian and Weiss Analytics to give you the information you need to understand the market drivers, the profile of the target HELOC customer, and how you can position your company to grow your HELOC business.

[1]https://www.housingwire.com/articles/48132-americas-equity-rich-properties-increase-to-record-high

Market Conditions Driving the HELOC Resurgence

According to Experian data and analysis, a variety of macroeconomic and credit trends make this the perfect market for HELOC growth.

Ongoing Economic Stability

First off, on a macro level, the economy is still going strong. Inflation rates are low, the Gross Domestic Product (GDP) is steady, and both consumer confidence and investor confidence remain high. Unemployment—the number one indicator that people are going to pay their bills—is holding steady between 3.9 percent and 4 percent, and expected to stay at those levels for the next three years.

To net it out, consumers have more purchasing power, more jobs, increased solvency and a belief that their financial futures will continue to look bright. All of these factors combine to form an ideal landscape for credit growth, particularly in the area of HELOCs.

Economic Growth

- **Consumer confidence continues to rise**
- **Investor confidence remains high**
- **U.S. inflation Down**
- **Real GDP remains strong**
- **Unemployment remains low and forecast to stay low in the near future**

Indicator	4Q-2006	4Q-2018
Consumer confidence	106.8	128.1
DOW - Investor confidence	12,315	24,370
U.S. inflation	2.5%	1.9%
Real GDP	3.5%	4.9%
Unemployment rate	4.5%	3.9%

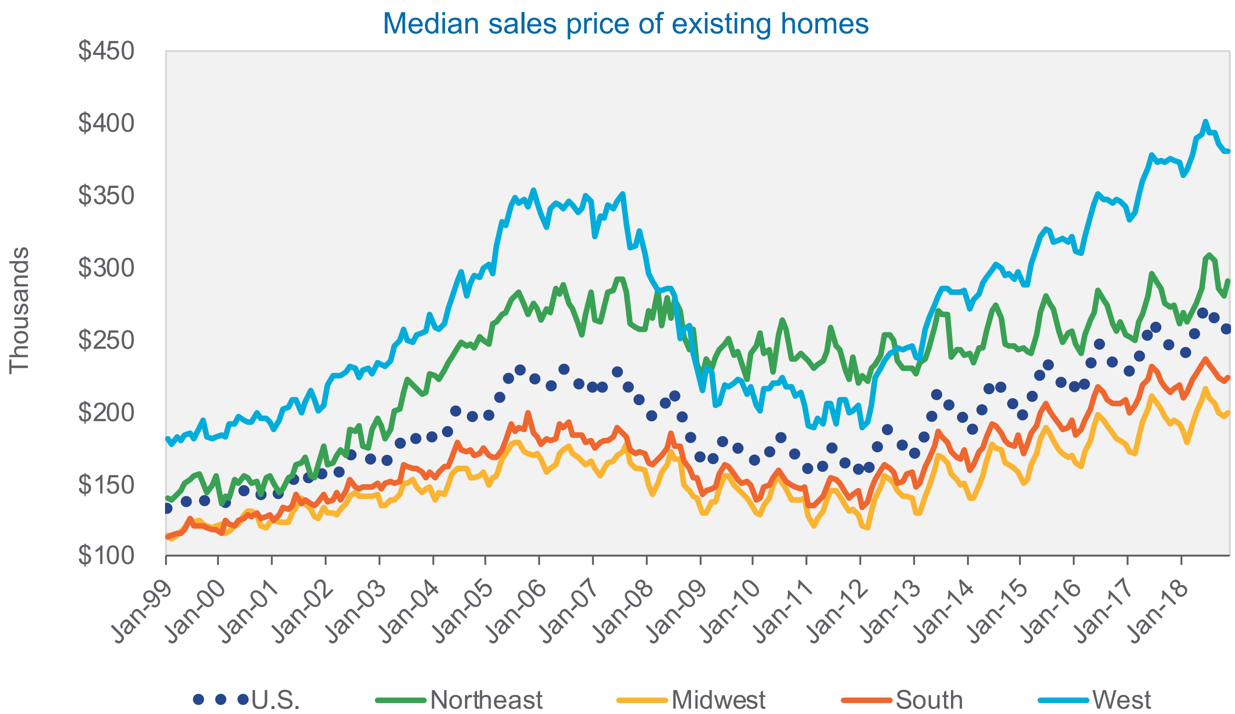
Increasing Home Values

Home values are also on the rise, which is good news for current homeowners. The median sale price of an existing home is up 4.2 percent year-over-year, and up 16 percent since Q4 2006. As a result, the average price of a home today comes in at about $258,000, significantly higher than historical averages.

These value increases have triggered a domino effect. More people are staying in their homes because they can't find another property in their price range. This lack of consumer transience further depletes the inventory, so, when a property does become available, bidding wars often drive the purchase price up, well beyond the original asking price.

Those consumers who stay in place have accumulated significant equity, which makes them ideal targets for HELOC loans.

Home Prices Are Up and Soaring Opportunity in HELOC



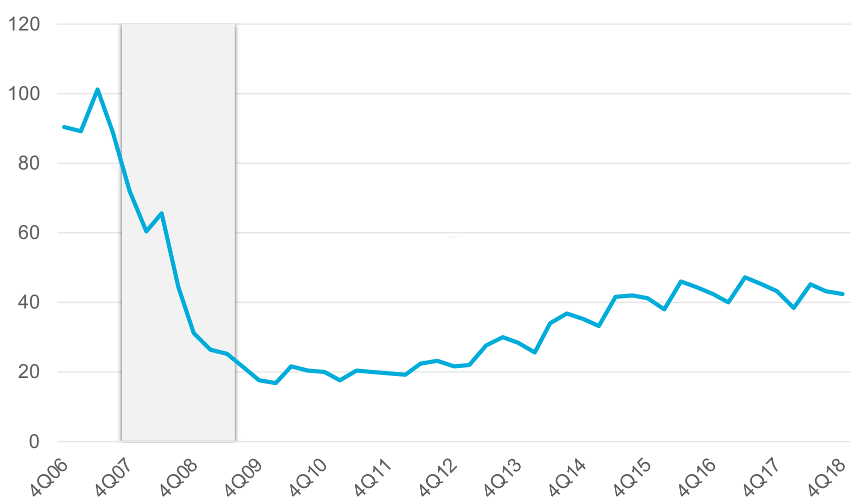
A Largely Untapped HELOC Market

The HELOC boom of 2006 dropped off precipitously after the recession, as anyone who was around at the time remembers. Although HELOC originations rose to $42.4B in the fourth quarter of 2018, that number is actually 53 percent lower than where it was in 2016. The gap between current HELOC originations and the projected market potential represents an untapped opportunity. People are seeking out credit, but many of those transactions have come in the form of personal loans, because they're simple and speedy to get. Some consumers may not be familiar with how a HELOC works or its benefits, so they are paying more for accessing cash from other types of products.

According to Experian analytics, which combined credit data with Weiss Analytics property evaluation data, the market for new HELOC business is an estimated $733B[2].

Lenders who can actively educate their customers on the benefits of HELOC, offer the right mix of products, and make the process fast and easy, have a real opportunity to capture this untapped market.

HELOC New Origination Dollars Have Risen Since The Recession But Still Down 53% Since 2006



[2] By combining credit data with Weiss Analytics property evaluation data, Experian analysts created a sample group of consumers who had one open mortgage and no current HELOC loans, and narrowed it to include consumers who:

- Had less than 80 percent CLTV (combined loan-to-value ratio)
- Had a risk score greater than 700
- Had a DTI less than 45 percent

Then, they applied VantageScore In the Market Model(SM) (ITMM), which identifies the probability of whether or not a consumer will actually open a HELOC. Then, they narrowed these results by "high propensity" and "lower propensity" to get a realistic look at the market potential.

- 3.2 million people had a high propensity to open a HELOC, worth an estimated $263B in market potential, based on actual borrowing power.
- 7 million had a lower, but still viable, propensity to open a HELOC were worth $470 billion in market potential.

That derived the combined market total of $733B

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Profiling the HELOC Customer

So, what does the average HELOC customer look like?

Experian researchers used a combination of credit bureau data and Weiss Analytics data to answer that question. According to their analysis, the current, typical HELOC customer fits into the following categories:

Baby Boomer

Because HELOCs are so fundamentally linked to home equity, it comes as no surprise that the vast majority of current HELOC borrowers are 35 years old or older. More than half of this group—a full 55 percent—are Baby Boomers.

This group has had time to build up the equity in their homes, and are largely choosing to age in place, instead of incurring the additional expense or tax increase that could come from moving to a different locale.

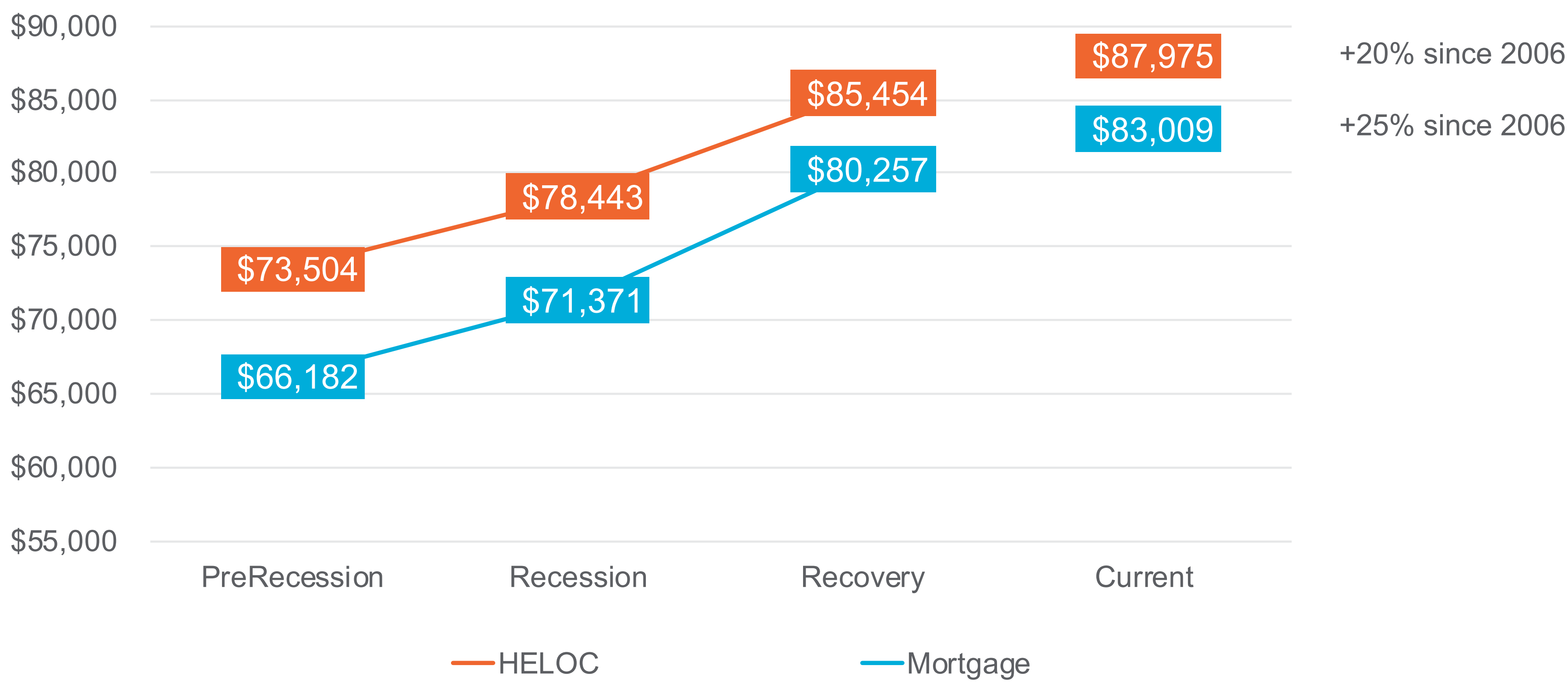
Although Boomers should clearly be most lenders' target market, Gen Xers do make up 24.5 percent of current HELOC holders, so there may be some opportunity there, as well.

High Household Income

Traditionally, HELOC customers have high household incomes, even when compared to the average incomes of people who hold mortgages.

In prerecession times, the average income for a mortgage was around $66,000, compared to an average income of $73,000 for HELOCs. Today, those numbers have increased to income averages of just above $83,000 for mortgages, and almost $88,000 for HELOCs, with an average debt to income of just 39 percent.

Income Insight - Existing Customers



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Prime or Better Credit Score

This group is also made up of people who know how to use, but not abuse, credit.

A whopping 94 percent of consumers who originated HELOCs were classified as prime or super-prime borrowers. Their credit scores typically fall in the 721 to 735 range, as opposed to personal loan holders, whose credit scores typically land around 635.

While the main HELOC target will be those prime and super-prime homeowners, lenders also might consider individuals whose credit scores fall somewhere in between 635 and 721. When matched with the right product (first lien, piggyback, second lien, fixed rate, variable rate, etc.) this group could represent another pool of good, lower-risk prospects who may not have considered the HELOC option.

How HELOC Customer Behaviors Compare to Other Borrowers

In addition to partnering with Experian to explore market conditions and prospect demographics, Ellie Mae conducted a consumer survey in Q4 2018, to compare the behaviors of HELOC customers to the propensities of borrowers using other types of loans.

These key findings from that survey provide insight into how these borrowers shop for a HELOC loan, how they make their buying decisions, and what they expect from their HELOC providers.

The Lender Search Begins Online

While conventional logic might indicate that borrowers automatically go to their mortgage originator when they're seeking a HELOC, this is typically not the case. More than half of the HELOC customers surveyed used an online search to find a lender.

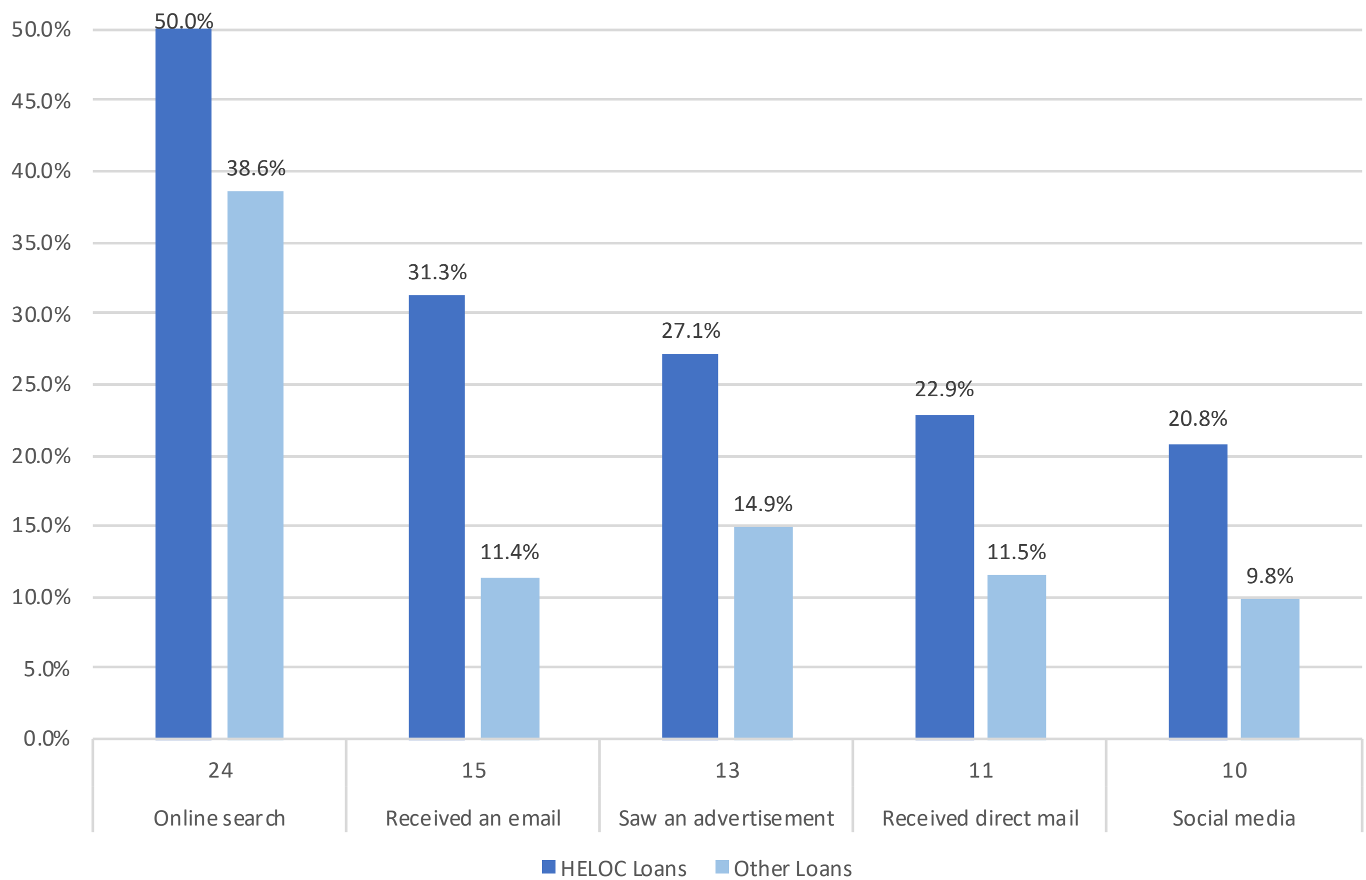
In many cases, the search was prompted by a direct mail piece, an advertisement or a post on social media. So, if the idea of a HELOC is suggested to them, target customers typically research the options on their own, comparison shop and ultimately, make their buying decision based on their research.

Would these customers take the same approach had their lender actively maintained that borrower relationship? Possibly not.

However, these findings do underscore the need for HELOC providers to devise a well-planned, targeted marketing strategy, and ensure their messaging on web sites, blogs and social media clearly lays out their HELOC value proposition.

Finding a Lender

- **HELOC borrowers used most methods more often than other borrowers to find their most recent lender**
- **The differences between their use of referrals and existing bank and lender relationships for finding a lender were not significantly different**



Ellie Mae Borrower Insights Survey, December 2018

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Mobility Rules

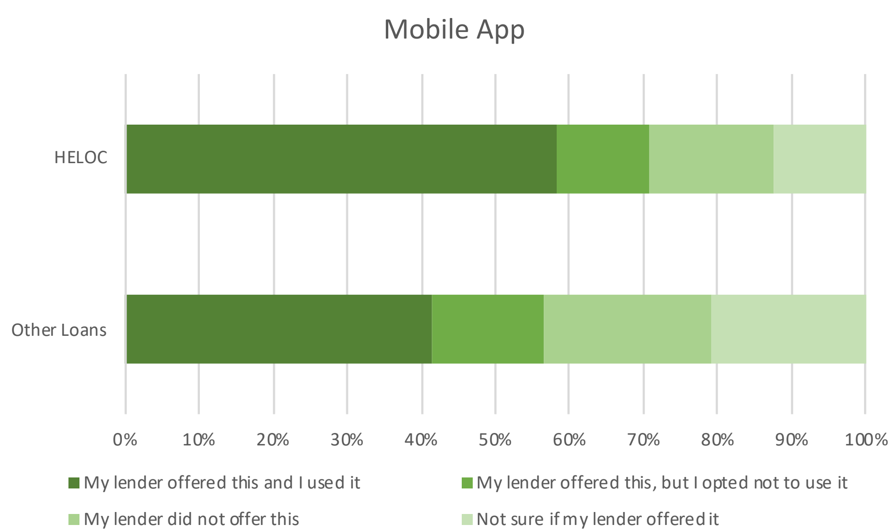
Compared to other borrowers, the HELOC customers surveyed were more likely to use mobile apps, and use them more frequently than online portals—even though the majority of those surveyed were Baby Boomers.

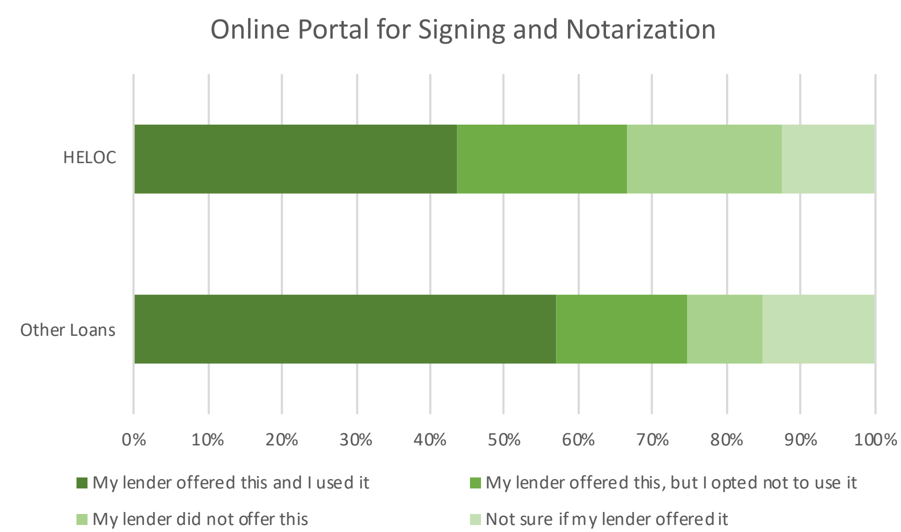
This fact speaks to the democratization of mobile, not only from a socioeconomic perspective, but from an age perspective. In the early days of the digital age, the prime users of convenience features were Millennials and Gen Z. Today, more consumers, particularly those fitting the HELOC borrower demographic, are not only comfortable with, but are demanding a mobile option.

In fact, the HELOC customers surveyed indicated that their ultimate buying decision was influenced by whether or not the lender offered a mobile app and online portal for document upload. So, these features are now table stakes for anyone who wants to capitalize on this market.

HELOC Usage of Mobile App and Online Portal

- **Compared to other borrowers, HELOC borrowers reported a higher usage of mobile apps and a lower usage of online portals for signing and notarization**





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Human Contact is Still a Factor

Although technology is key to attracting HELOC customers, these borrowers do want to complement their online loan applications with human communication.

It's interesting to note that, compared to individuals taking out other types of loans, HELOC borrowers were contacted less often than other borrowers throughout the entire loan process. However, they were also 27 percent more likely to describe their lender as "attentive" than borrowers who chose different loan products.

This finding speaks to the fact that acquiring a HELOC is a much simpler process than a mortgage or refi or some other lending options. It also is likely due to the fact that HELOC customers have already been through the mortgage process. So, they are more experienced borrowers.

As a result, loan officers may be able to spend less time handholding and still deliver an excellent borrower experience. Borrowers want contact, but don't need to be shepherded every step of the way.

Taking Advantage of the HELOC Opportunity: The Fundamentals (Top Tips for Success)

Before ramping up to take advantage of the growing need for HELOC, lenders should take a step back, assess their individual market and make sure they have all the elements in place to succeed.

Start the process by doing the following:

1. Identify Your Market Potential

Use analytics to comb through existing pipelines to identify customers who could be candidates for HELOC loans. You can overlay the industry profile of the typical HELOC customer—high equity, $88,000+ annual income, low debt-to-income ratio, prime credit rating—as a starting point.

But, also, dig deeper, using what you know about these customers to identify those whose life stage or personal circumstances might be well served with a HELOC. Look at:

- **The ages of the dependents. Are one or more of the borrower's children close to college age? An engagement? Or, buying their first home?**
- **Age of property. Is the residence old enough that it's time for renovations to update, add new "smart" technologies or take advantage of energy-efficient products?**

Use any information that you have in your CRM system to understand the scope of the market opportunity, as well as the individual needs of your potential borrowers.

2. Identify the Type of HELOC Products that Fit Your Market Need

It's important to offer a broad array of HELOC products (first lien, piggybank, different term rates, interest-only draw, interest and principal) that will enable borrowers to get the right fit for their individual financial situation and goals.

With the current state of the housing market, many homeowners may have already paid off their existing mortgage. These clients are a great match with a first lien HELOC product. If you are looking to support renovation products with flexible offerings for the borrower to access, consider including a piggyback HELOC offering. These can be done standalone, or in partnership with another lender. At the same time, review your credit policy. Do you want to be able to offer multiple combinations of payment options during draw and repay to fit multiple risk profiles?

Start by creating a portfolio that meets your existing customer needs. Then, look at what your competition is doing. You want to be able to have the right offering for your warm market, but also compete for new customers, as well.

As your HELOC business expands, continually assess your portfolio and refine as you go.

3. Determine If Your Loan Origination System Can Support Multiple Types of HELOCs

As with mortgages and refis, lenders have to offer their HELOC customers a stellar experience, and move from application to funding more quickly and easily than they expect. To that end, the LOS has to be flexible enough to support different types of HELOCs, from first lien, to piggyback, to standalone second lien; as well as providing multiple different payment calculation options.

Because some types of HELOC loans are now HMDA reportable, find out if processing them through the LOS enables you to apply the system's built-in compliance features to these loans, which reduces risk and speeds efficiency by eliminating manual checks.

4. Ensure You Can Take Online and Mobile Applications

The availability of mobile and online applications and uploading capabilities can be a determining factor as to which lender gets the customer's business. Make sure you have these tools in place before you launch your HELOC initiative.

5. Confirm that Your Servicing System Can Accommodate HELOC Servicing

If your servicing system does accommodate HELOC, make sure it integrates with your origination system, so you have a seamless workflow. If it doesn't, then you have to evaluate your options before launching your program.

Putting the Right Marketing Strategies in Place

After you put the infrastructure in place, it's time to let people know that you offer a variety of HELOCs. The channels and advertising tools that works best for each lender will differ, based on the profiles of the customers it's targeting, product mix and marketing philosophies. The real key is adjusting the messaging for the specific needs for each market segment. Whereas a Baby Boomer or Gen Xer may want to add on to their existing property, the Millennial may want to use equity for a down payment on a larger home, or pay off student debt. They key is finding the value proposition that fits each segment and then, refine that for each individual borrower need.

Consider offering promotions, like a discounted introductory rate for the first 6 to 12 months, and advertising those deals to engage customers.

Differentiate yourself in the market by providing easy ways for consumers to access their home equity funds or the offering the ability to convert a portion of their borrowed funds to a fixed-rate installment loan.

Advice from the Trenches: One Lender's Perspective

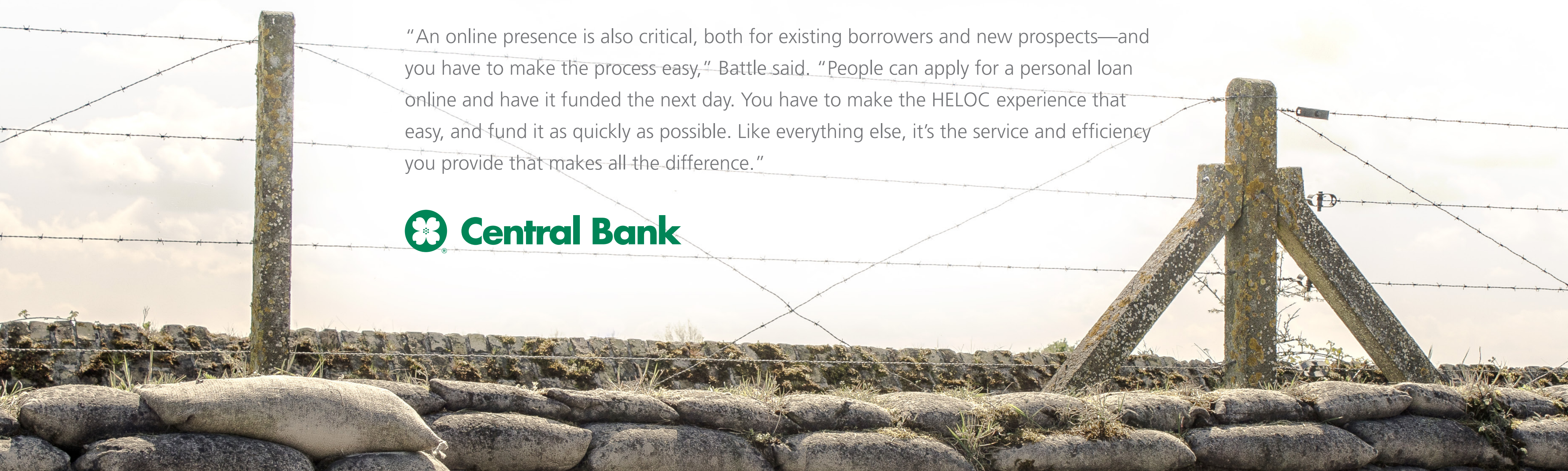
Ruth Battle, the Chief Mortgage Underwriter at Central Bancompany has a clear world view of what it takes to be a strong HELOC lender. At Central Bancompany, these lending tools account for nearly 30 percent of the institution's overall loan volume.

"We make our customers aware of HELOCs through mailers, messages in statements, signage and banner ads—the more traditional marketing tools. But, I think the difference is the way our staff looks at HELOCs, and approaches them as a whole," Battle said. "In my previous company, we didn't offer HELOCs because the leaders didn't think there was enough money in it. Here, our staff is more focused on finding the right financial solution for our customers—that's our culture. We have the kind of relationships where we know when a customer has life changes that might require borrowing from asset 'A' to asset 'B', and when HELOCs are the optimal choice."

For organizations expanding their portfolios to include HELOCs, Battle recommends not only educating originators on this financial tool, but also adjusting compensation plans to incent them to talk about HELOCs with their customers.

"An online presence is also critical, both for existing borrowers and new prospects—and you have to make the process easy," Battle said. "People can apply for a personal loan online and have it funded the next day. You have to make the HELOC experience that easy, and fund it as quickly as possible. Like everything else, it's the service and efficiency you provide that makes all the difference."

Central Bank



How Ellie Mae Can Help

At Ellie Mae, we are committed to helping our customers succeed, empowering lenders with technology solutions that boost origination volume while reducing the cost of origination, support consumer engagement and drive success with a true digital mortgage. Our goal is to keep our customers one step ahead of the trends, and ensure our solutions enable them to take full advantage of any new market opportunity.

The Encompass Digital Lending Platform offers an end to end HELOC lending solution that helps banks, credit unions and traditional mortgage lenders acquire HELOC customers and originate and sell HELOCs with greater efficiency at a higher ROI. Using the Encompass Digital Lending Platform, lenders can simplify and automate every aspect of their HELOC workflow, ensure quality and compliance and deliver better customer experiences all at the same time.

Click here to get more information on Ellie Mae's HELOC solutions:

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